To the rescue?

Summary
• The focus on social considerations has broadened in recent years, with growing scrutiny on corporate social responsibility as a result of the pandemic and cost-of-living crisis.
• Certain investments present an opportunity to support the government's growth agenda, as well as create a positive social impact, such as social housing and health. Yet barriers remain.
• Progress is underway, with a Taskforce on Social Factors recently launched to create guidance for pension scheme trustees and managers, alongside a number of emerging new investment vehicles.

Sophie Smith takes a closer look at industry efforts to manage social investment factors, and how this could tie in with recent calls for pension schemes to invest more in the UK economy

Social considerations have seemingly suffered from middle syndrome child within the realm of environmental, social and governance (ESG) factors. Yet, Van Lanschot Kempen head of client advice, Arif Saad, says that sustainability and ESG has taken a wider lens in recent years, revealing that the firm has seen an increase from clients on questions and concerns on social factors, a trend that is expected to continue.

And it is not only the ESG lens that has widened, as Pensions and Lifetime Savings Association (PLSA) deputy director of policy, Joe Dabrowski, says the way that pension schemes have thought about social factors themselves has also evolved.

"The primary focus used to be on general business conduct," he says. "That has evolved over time, and while it still includes lots of those supply chain issues and modern slavery issues, it also includes the wider systemic risks, so things around product development, water supply issues, housing supply issues, and other things."

But this has also prompted increased concern for pension schemes, as the Department for Work and Pensions' (DWP) 2021 call for evidence revealed that institutional investors are concerned about the potential material risks posed by modern slavery in particular.

Progress is being made though, as, following the 2021 consultation on social considerations, a Taskforce on Social Factors has been established, with support from the DWP.

Aegon head of responsible investment, and member of the taskforce, Hilkka Komulainen, says that the taskforce will help to "demystify" the 'S' and highlight the materiality of considering risks and impacts related to people in pensions investments.

"Despite the relevance of social issues and particularly responsible business conduct to long-term business success, there has been less focus on social factors compared to environment and climate change, and we still have low levels of awareness of the materiality of social factors in investment performance," she says.

Two birds, one stone?

The growing focus on social considerations has not been the only recent investment trend, as mentions of social impact have increasingly appeared alongside calls for UK pension money to better support the UK economy.

Former Pensions Minister, Ros Altmann, for instance, recently called on the government to require pension schemes in the UK to support various areas of UK growth, including infrastructure and social housing, to deliver "better outcomes for pensions and the economy", with similar calls to 'unlock' UK pension assets to drive economic growth also made by the Capital Markets Industry Taskforce (CMIT).

Recent research from Alpha Real Capital also found that 98 per cent of UK Local Government Pension Scheme (LGPS) fund professionals believe that an allocation to social infrastructure supports levelling up.

However, Hymans Robertson senior investment consultant, Iain Campbell, warns that whilst the aim of investing in a manner that supports the UK economy is intended to be beneficial to society, as with all investments, there are risks.

"Here the risk isn't simply financial for the investor but also for wider society; for example if the investment had significant social purpose such as an important piece of social infrastructure," he says. "A prime example are investments in social housing projects that are not properly run. Here, pension schemes need to be very careful to partner with reputable and knowledgeable investment managers who understand and manage these risks on your behalf."

Adding to this, Franklin Templeton head of UK institutional, Dean Heaney, says that, in evaluating social risks associated with the fund investments, schemes also specifically need to consider how the beneficiaries are impacted.

"This may vary case by case, but some will be consistent such as employee welfare and human capital management topics, for instance, employee protection and freedom of association," he says. "Managers have the ability through the use of the scheme's ownership rights to influence corporate behaviour, hence can maintain loyalty to their beneficiaries by recognising their ability to act on these risks and provide opportunity through addressing them."

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Despite the risks, Campbell agrees that there are also plenty of opportunities that pension schemes can take advantage of to bring positive social impact with their investments, with social housing again a prime example.

"Similarly, we are seeing growth in demand for social infrastructure projects," he says. "These aim to address social issues such as decarbonisation, health and education, digital inclusion and waste solutions; filling gaps previously addressed by government spending."

And whilst Campbell notes that tilting capital allocation towards investments that support the UK economy can lead to potential issues, such as a lack of diversification opportunities and limiting investment opportunities to a smaller subset, this does not necessarily have to be the case.

"There are plenty of examples of investments of this type made by pension schemes already, particularly LGPS funds, that have been extremely successful from both a risk/return perspective but also the positive impact it has had on the UK economy and society," he says. "Careful thought is required when investing in this manner, however, if done correctly, there are opportunities out there that help to meet both fiduciary duty and any requirements for supporting the UK economy."

Keeping it local

And LGPS fund professionals do expect an increased focus in this area, as Alpha Real Capital's research found that 87 per cent believe the funds they help to manage will increase their focus on generating a positive social impact from their investments.

However, Alpha Real Capital's survey also identified a number of barriers around investing in social infrastructure, with knowledge of the investment and impact characteristics as the biggest barrier, followed by availability of market opportunities, and restricted illiquidity budget.

And whilst the government has announced plans to "lead by example" by pursuing accelerated transfer of the £364 billion LGPS assets into pools to support increased investment in innovative companies and other productive assets, some industry experts are not convinced about the impact it may have.

In particular, the government announced that it is looking to consult on proposed requirements for LGPS funds to transfer all listed assets into their pools by March 2025, with a further consultation expected on requiring LGPS funds to consider investment opportunities in illiquid assets, such as venture and growth capital.

Doing well or doing good?

However, Dabrowski says that there is already a lot of inward investment within the LGPS, suggesting that the requirements "may not result in much change".

Furthermore, Campbell clarifies that the potential required pooling of listed assets by 2025 does not necessarily have a huge impact on social investment, as most social investments are made through illiquid assets.

Broader changes could be down the line, however, as the Chancellor hinted at plans to announce further DC measures in the Autumn Budget.

And behind-the-scenes discussions are underway, as HM Treasury also recently confirmed that the Chancellor held a roundtable with representatives of the UK pensions industry to discuss the scope for "greater industry-led investment into cutting-edge companies across the United Kingdom".

Yet while industry experts are keen for the government to further address the barriers facing investment in some social opportunities, many remain wary of any compulsion.

Hymans Robertson, head of DC investment, Callum Stewart, for instance, says that to maximise the potential for competition,which can drive improvements in outcomes, it will be necessary to support a diverse and well-functioning market.

Given this, he cautions against over-regulation to require specific investments, warning that this could constrain market thinking and lead to unintended consequences, such as a compromise on quality.

"We absolutely would not agree with any form of mandating," agrees Dabrowski, also raising broader concerns around the division between investing in the UK and investing for social impact.

Indeed, Dabrowski points out that while many of the recent opportunities talked about for future growth, such as the Treasury's proposals for a Long-term Investment For Technology and Science initiative, may have a "tangential social element", it isn't necessarily investing in a social way.

"I think *[investing in the UK economy and growth]* are not necessarily the same things as trying to invest for impact or investing with a social focus. Those things cross over, but it gets difficult blurring them all together, so it's important for schemes to distinguish between these and be really clear about what outcome they are trying to be achieved and how that fits with their investments," he says.

The work of the taskforce could help provide clarification in this area, however, with efforts to identify reliable data sources particularly expected to help trustees and wider industry manage the social risks and opportunities that may arise when investing in the UK economy.

"While there is data already available across a spectrum of social issues, the metrics used are not standardised, and there are challenges with quantifying and modelling systemic risks that are economy wide," Komulainen says. "The taskforce seeks to support and empower trustees and pension schemes to ensure material social factors are identified, assessed and managed in pension portfolios, contributing to better pensions stewardship on topics related to people."

Increasing transparency will also be key to social investing efforts more broadly, as Heaney argues that investors need to ensure that the underlying manager has the trust and ability to implement an effective fund management strategy that meets the beneficiaries' goals.

Written by Sophie Smith

Long-Term Asset Funds

The emergence of Long-Term Asset Funds (LTAF) could potentially play a role in addressing both the investing for UK growth, and investing for social good, trends, with the Financial Conduct Authority recently granting Schroders permission to launch the first LTAF.

People's Partnership director of policy, Phil Brown, highlights the approval of the first LTAF as demonstration that the government's policy to encourage greater investment in illiquid assets is "already delivering and should be given time to work".

Schroders has since announced the launch of an LTAF designed to help UK pension scheme investors support the net-zero transition. Despite the initial focus on net zero, one of the four key themes for the strategy is around social vulnerabilities.

LTAFs could play a key role in taking advantage of social opportunities more broadly, as Franklin Templeton head of UK institutional, Dean Heaney, says that LTAF's are a "powerful product that can support greater democracy in the capital markets in a number of ways".

"These long-term investment vehicles allow the savings of plan participants to access new types of investments (for example social infrastructure investments, such as affordable housing), and for their capital to be deployed into areas that may have significant impact on addressing societal challenges, given the role private assets can play in moving quickly and directly to effect change," he continues. "The diversity of investment this offers allows participants to maximise their financial wellbeing and access opportunities previously only available to large institutions."

However, Heaney stresses the need for the end investor to be aware of the different linkages and role private markets play in the wider capital markets system.

"Primary and secondary capital markets operate and effect change on social issues in fundamentally different ways," he explains. "Investors should be made aware how these investment types operate differently, so that they have the right information to assess whether social considerations are being met. Secondary market investments will be exposed to social risks differently to primary market, and there will be different effective routes to address these risks as a result."